March 30, 2008

Office of Regulations and Interpretations,
Employee Benefits Security Administration,
Regulations, Room N-5655,
U.S. Department of Labor,
200 Constitution Avenue, NW,
Washington, DC 20210.

Attn: 2010 Investment Advice Proposed Rule

E-mail to e-ORI@dol.gov

DALBAR appreciates the opportunity to comment on the proposed regulations implementing the provisions of the statutory exemption set forth in sections 408(b)(14) and 408(g) of the Employee Retirement Income Security Act, as amended ("ERISA").

DALBAR Background

DALBAR has a 30-year history and is recognized by industry and government as an independent third party expert in the business of providing evaluations, ratings and due diligence. DALBAR certifications are recognized as mark of excellence in the financial community for advice services, communications, electronic and telephone services.

DALBAR's experience and expertise includes retirement plans, broker/dealers, insurance companies, investment advisers and investment companies.

In 2010, DALBAR launched the first national ratings of Individual Retirement Account (IRA) platforms. The IRARatings are a standardized method of comparing IRA products from the various financial services sectors.

DALBAR was first to conduct ERISA 408(g) Annual Audits for level fee fiduciary advisers based on the Field Assistance Bulletin of February of 2007 ("FAB 2007-01"). The DALBAR audit is consistent with 408(g) and, except as noted below is also consistent with the regulations being proposed. The DALBAR audit consists of the following steps:

- Fiduciary Adviser initiates the audit through a disclosure questionnaire that is reviewed for compliance with 408(g).
- After review and acceptance of the disclosure questionnaire DALBAR initiates a request for documents, including eligible investment advice arrangements ("EIAA"), disclosure documents, tools used in advice delivery, records relating to advice delivery and complete list of plans and participants receiving investment advice.
- Documents are examined upon receipt for compliance with 408(g) using the auditor's checklist and are compliance tested by contacting a sample of plans and participants.
- Results are analyzed and two documents are produced. The Audit Report and the Management Letter. (Samples are available)
- The two documents are reviewed with the fiduciary adviser after which the Audit Report is delivered to all of plans with whom the fiduciary adviser has an EIAA.

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DALBAR intends to act as an "independent expert" to certify computer models as described in the proposed regulation.

Our experience with these audits leads to the requests for clarification, concerns and answers to specific questions raised in the proposed regulations.

Requests for Clarification

Dual Registrants

Proposal paragraph (b)(3)(i)(D)[1] prohibits level fee advisers from receiving compensation based on investment options selected by participants or beneficiaries. This paragraph raises the question regarding registered representatives who are registered both as a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) ("RR") and a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) ("IAR"), known as "Dual Registrants". There are a large number of such Dual Registrants that could be prohibited from using the level fee exemption, depending on the scope of this prohibition.

These Dual Registrants meet the fee leveling requirement as an IAR. However, for separate and distinct activities the Dual Registrant may act as an RR and is compensated based on assets or sales of the same or similar investment options as those used by participants or beneficiaries.

Please clarify whether the prohibition of (b)(3)(i)(D) extends to Dual Registrants who are compensated for unrelated activities.

Computer Model Certification

Certification of computer models used to comply with section 408(g) requires a determination that the computer model is not biased[2]. This requirement raises the question of the effect of the mix of investment options made available to the computer model. For example, a computer model can be populated in one or more classes with investment options offered by the fiduciary adviser. The effect of such a mix is to favor the investment options offered by the fiduciary adviser.

Should a computer model be certified without knowing the mix of investment options that will be made available to it?

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[1] (b)(3)(i)(D) No fiduciary adviser (including any employee, agent, or registered representative) that provides investment advice receives from any party (including an affiliate of the fiduciary adviser), directly or indirectly, any fee or other compensation (including commissions, salary, bonuses, awards, promotions, or other things of value) that is based in whole or in part on a participant's or beneficiary's selection of an investment option;

[2] (b)(4)(i)(E)(1) Inappropriately favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options, if any, available under the plan;

(b)(4)(i)(E)(2) Inappropriately favor investment options that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser;

Concerns

Plan Sponsor Incentive

One expressed goal[3] of proposed regulation is to encourage plan sponsors to make unbiased investment advice available to workers. The proposed regulation should therefore include an incentive for plan sponsors to adopt an investment advice program. Without an incentive we are concerned that the investment advice exemption will not be available to very many workers.

Current investment advice programs are primarily computer based and have very low utilization. Our studies show that utilization of investment advice increases significantly (by a factor 10 to 25 times) when investment advice is delivered through an investment professional.

It is our view that plan sponsors will adopt the more effective level fee adviser if such adoption (preferably in combination with a QDIA) would fulfill the requirements of ERISA 404(c). Such an incentive will materially reduce the costs that are associated with 404(c) compliance (materials, administration, time, travel, lost productivity and the cost of investment errors). In a large number of plans the cost of 404(c) compliance exceeds the cost of investment management and record keeping. Such a change will also have the beneficial effect of making unbiased investment advice more available to participants and replace many of the failed practices used to comply with 404(c).

Annual Audit by Omission

Proposed regulations governing the annual audit define its scope as investment advice rendered under an Eligible Investment Advice Arrangement ("EIAA"). Furthermore, there is no disclosure required for cases in which an EIAA is not being used[4]. In the absence of an EIAA the independent expert conducting the annual audit cannot determine if an EIAA should have been used but was not.

The concern is that the annual audit will be incomplete without explicit disclosure of services rendered in which no EIAA was employed.

Answers to Specific Questions

Investment Theories

The question of what constitutes a generally accepted investment theory has been problematic in conducting annual audits. Fiduciary advisers have reported using theories that range for "Modern Portfolio Theory" to "Style Boxes" and explanations of risk assessment. (See Appendix for examples). With no guidance as to what qualifies and what does not, we have found it difficult to explain a deficiency.

The situation would be greatly improved if the proposed regulations were amended to include a process for making this determination. This process could include the use of a panel of investment managers who would develop and use a uniform set of criteria to determine if an investment theory is generally accepted.

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[3] Per the *Annual Report of the White House Task Force on the Middle Class* "These regulatory actions include… Encouraging plan sponsors to make unbiased investment advice available to workers, helping workers avoid common errors that undermine retirement security, while providing strong protections against conflicts of interest."

[4] Cases where the need for an EIAA is not evaluated includes circumstances when advisers claim to operate with no conflicts of interest, under SunAmerica (AO 2001-09A), under ERISA 3(38), provide only education (IB 96-01) or under Frost (AO 1997-15A).

New theories could be presented to this panel for acceptance.

A list of accepted theories could then be published to facilitate compliance.

The same list of theories could be used to determine compliance with a similar requirement for Qualified Default Investment Alternatives.

Historical Data

Historical data serves two distinct purposes in the investment advice model. One is screening for investments that qualify for inclusion and the second is determining the expectation of future performance.

In screening for which investments qualify, the historical returns are essential. Without the past returns very poor performing investments or those with no record of performance can be recommended to participants and beneficiaries. It should be considered a requirement of the exemption to include only investments with an acceptable record of past performance.

Historical data used for determining the expectation of future performance should not be based on the performance of individual investments but instead use the performance of the entire class.

It is our view that historical data used in these ways should cover at least five years and reflect the probability of repetition based on the uniformity of performance over the entire history of the investment or class.

Thank you for your consideration of these comments in developing the final regulations.

Louis S. Harvey
President

APPENDIX

Examples of level fee fiduciary adviser responses to:

"Please describe the investment theory you use to advise plan participants (Attach details if necessary)"

- I am a CFP; I use the principles of proper financial planning based on age, risk tolerance, and client objectives.
- We practice asset allocation utilizing modern portfolio theory. Asset allocation advice is based on a risk/asset questionnaire and assessment of goals.
- Currently, we provide personal clients with initial consultation that involves questions about their investment goals, retirement goals, risk tolerance. During the second meeting we provide them with a retirement calculation and recommendations on which investments to choose. We help them to choose good solid investments but also believe in active management. This means that it's not a "buy and hold forever" strategy but a "buy and hold" unless it is appropriate to make changes due to economic fluctuations or fund performance deficits.
- Holistic Financial Planning. The Recognition of who the client is and his total financial make-up.
- Primarily asset allocation based on an initial IPS. I consider the periodic rebalancing and monitoring of this initial strategy to be the most critical factor for success.
- Modern Portfolio Theory/Asset Allocation
- Modern Portfolio Theory based on Dr. Harry Markowitz's theories.
- We use MPT statistics (alpha and beta), along with ratings, track record and management tenure to evaluate funds. We use a planning approach with software to develop a recommended contribution to meet the retirement goal at a return based upon the participants risk tolerance/time horizon. We maintain five investment models that we can tailor to the clients specific needs and/or the investments available. The models are based upon a classic strategic asset allocation approach and we can tactically modify the model to fit current circumstances, unique investment opportunities/funds available thru the plan (like company stock or sector funds), or the participants preferences.
- I use portfolio theory and asset allocation primarily with ETFs which I actively manage. I blend other investments to manage risk or improve alpha. I believe in reducing risk with diversification and in tactical weighting. But in qualified plans I would use strategic weighting with the options offered in the plan.
- Based on Modern Portfolio Theory, I advise clients based on their risk tolerance, time horizon and goals for their assets. I evaluate all of their holdings and accounts to determine the most appropriate asset allocation model. Utilizing the services of Morningstar, Ibbotson and the Efficient Frontier, we propose allocations that best meet the needs of the client.
- Diversified Portfolio, Asset Allocation, Non-correlated Asset Mix, Rebalancing.